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RUEHDJ/AMEMBASSY DJIBOUTI 0127
RUEHBH/AMEMBASSY NASSAU 0232
RUEHDK/AMEMBASSY DAKAR 1706
RUEHWN/AMEMBASSY BRIDGETOWN 0411
RUEHLM/AMEMBASSY COLOMBO 0412
RUEHUB/USINT HAVANA 0247
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SENSITIVE
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STATE FOR EEB/IFD/OMA
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PASS EXIM FOR CLAIMS - MPAREDES
PASS USDA FOR CCC -- ALEUNG/WWILLER/JDOSTER
PASS USAID FOR CLAIMS -- WFULLER
PASS DOD FOR DSCS -- PBERG

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TAGS: EFIN ECON EAID XM XA XH XB XF FR
SUBJECT: PARIS CLUB - JUNE 2009 TOUR D'HORIZON AND DISCUSSIONS ON
METHODOLOGICAL ISSUES

¶1. (SBU) Summary: At the Paris Club's June 23 meeting, the U.S. opposed a proposal to give new seniority status to crisis-related bilateral financing. Russia dropped its opposition to extending Afghanistan's Club treatment, clearing the way for continued debt relief as Afghanistan implements its International Monetary Fund (IMF) program. The Secretariat reported Haiti was on track to reach completion point, with Paris Club negotiations on July 8. The Central African Republic (CAR) is on track for completion point, and we expect negotiations with the Club in September. Other countries of note on the June agenda included Congo-Brazzaville, Ecuador, Kazakhstan and Moldova. On June 24, the Paris Club held its annual meeting with non-Paris Club bilateral creditors and the private sector, followed by a high-level conference co-hosted with the International Institute of Finance on "The World Crisis and its Implications for Emerging and Developing Countries." The Club released its second annual report, available at www.clubdeparis.org. End summary.

AFGHANISTAN

¶2. (SBU) The only issue before the Club was extension of Afghanistan's interim treatment under the Heavily Indebted Poor Countries (HIPC) Initiative to support extension of its program

under the Poverty Reduction Growth Facility (PRGF). Russia, which had previously blocked the extension, consented with no discussion or elaboration. The Secretariat will send a letter to the Afghan authorities informing them of the decision.

ANGOLA

¶3. (SBU) The Club discussed paired letters received from the Angolan parliament and finance minister, asking that the country's January 2010 $400 million late interest payment to Paris Club creditors be swapped for development and social projects, although the minister also indicated that Angola would make the payment. Some creditors had received reports from a June 23 meeting in Luanda at which the proposal had been discussed, but the presentation apparently had not been clear.

The proposal was vague and confusing ("even in French," the Secretariat reported). It is not clear whether the Angolans foresee a mass swap with creditors, or individual swaps with each creditor. Several creditors expressed opposition; others were skeptical. The Club needs more information before considering the issue further. The World Bank reported that reserves had fallen from about $18 billion in January to less than $13 billion in April, reflecting oil

production and prices and the country's exchange rate regime.

ARGENTINA

¶4. (SBU) The main topic was Brazil's $700 million loan to state-owned Aerolineas Argentinas (and/or its subsidiary, Austral). Brazil failed to provide information about the loan, claiming a need to coordinate among three ministries, but promised to respond within a week. The Vice-Chairman requested a reply ahead of the July 8-9 Paris Club meeting.

¶5. (SBU) The U.S. asked about recent Argentine press reports that the GoA was again prepared to pay the Club. The Secretariat reported that the French Embassy in Buenos Aires had been told that the story had not originated with the authorities, and opined that payment in the short run was unlikely, despite the relatively good economic situation. The Secretariat would contact the authorities

again in late July or September, after the elections.

CENTRAL AFRICAN REPUBLIC

¶6. (SBU) The IMF noted that Argentine financing assurances were the only remaining obstacle to reaching completion point, and that the Board meeting had been delayed until June 29. The Fund representative summarized the completion point paper, and the Secretariat confirmed that negotiations with the Club were planned for September. (Note: Argentina subsequently provided the needed assurances; the IMF and World Bank Executive Boards approved completion point on June 29 and 30 respectively.)

DRC

¶7. (SBU) The main focus was again the Chinese loan. The IMF reported that its Managing Director had emphasized the issue during his recent trip to Kinshasa. The Fund had heard that the DRC authorities had requested that the sovereign guarantee be dropped from the mining portion of the project, keeping it on the $3 billion first infrastructure phase. (The second $3 billion infrastructure phase had been eliminated.) This could be codified during the first DRC-PRC annual review of the agreement, due by the end of June -- well before completion of the feasibility report, now expected by end-September. This would leave only concessionality as the major obstacle. The Fund reported that there was a notional interest rate in the framework agreement with China, but that loans extended under

it appeared to have been more concessional, some at a zero interest rate. Echoing the Managing Director's public statement, the IMF representative said the PRGF program was "not going to move forward without resolution" of the issue, and that there might be a freestanding Article IV review.

¶8. (SBU) The Fund reported that macroeconomic conditions were improving. Inflation, which had reached 100% in February, had dropped to 63% in April as a result of tight monetary and "relatively prudent" fiscal policies. Reserves, which had fallen to just $30 million in February, had risen above $200 million due to IMF and World Bank disbursements. Two and a half percent growth was projected for 2009, with inflation down to 30% by year-end, though the current account would widen by 6 percentage points to 21% of Gross Domestic Product (GDP). The Fund and the authorities had reached an ad-ref agreement on the macro framework and structural reform agenda for a new PRGF, with quantitative goals including 6% growth, single-digit inflation, and reserves rising to cover six weeks of non-aid imports; structural reforms were aimed at mobilizing revenues, strengthening management, and bolstering the economy's supply response through SOE reform and strengthening the private sector and regulatory environments. The program envisaged no government borrowing from the central bank, prudent monetary policy, and fiscal policy focused on small, labor-intensive projects.

¶9. (SBU) The World Bank reported that multilateral financial support had allowed the central bank to intervene to stabilize the currency and thereby moderate inflation, though inflation would still create fiscal pressures. The Bank also noted that President Kabila was asserting control of expenditures, at the expense of the Prime Minister, who was from another party. There were some indications that the DRC was working to revise the PRC deal. The Bank reported progress on structural reforms.

CONGO - BRAZZAVILLE

¶10. (SBU) The IMF reported Board completion of Congo-B's PRGF review, with satisfactory performance on all quantitative and structural conditions except for violation of the non-concessional debt ceiling and delays in meeting structural conditions. A mission was expected in late September. Completion point could come by year-end. Six of eight triggers had been met, and good progress had been made on the remaining two. The Bank noted significant performance on public financial investment and management, anti-corruption efforts, and other areas. The new French non-concessional loan for the port had required a waiver.

¶11. (SBU) The discussion then turned to Congo's $800 million settlement with litigating creditors, and the authorities' recent report to the Club explaining the amount. Fund staff were attempting to reconcile the data with information provided to the Fund and Bank for their annual litigation survey, but reconciliation seemed "quite challenging." The Secretariat would continue to refine its analysis and would discuss its calculations with Fund staff. Nevertheless, even by the authorities' reckoning the discount granted by the litigating creditors was 66%, less than full HIPC comparability, which required 78% in Net Present Value (NPV) terms.

ECUADOR

¶12. (SBU) The IMF reported that Ecuador had been buffeted by terms of trade shocks and falls in remittances and demand for exports. GDP was expected to fall 2% in 2009, after climbing 6.5% in 2008, oil receipts had plummeted by 60%, and remittances had fallen 10% in the first part of 2009. Non-oil imports had fallen 5%, in part because of trade restrictions (to be phased out by January 2010, per agreement with the WTO). The current account was expected to be in deficit by 2% of GDP in 2009, following a 2.5% surplus in 2008. Reserves had fallen from $4.4 billion at end-2008 to just over $2

billion. The deficit of the non-financial public sector was projected to reach 3% of GDP in 2009, suggesting the need for either expenditure cuts or additional financing, of 1.75% of GDP.

¶13. (SBU) Ecuador's recent offer to buy back $3.2 billion (6% of GDP) of defaulted bonds had been priced with a 66% discount, and attracted 91% participation, reducing public external debt to 20% of GDP while costing some $900 million. As a result of the offer's success, S&P had upgraded the country from selective default to CCC+. Bolstered by this success, Ecuador was reviewing the legitimacy of other debts. The Secretariat reported Ecuador's claim that almost all of the holdouts from its offer were retail investors, with just one fund perhaps included, and that it planned "discussions" with bilateral and multilateral creditors, although Italy reported the Ecuadorian Foreign Minister had not raised the issue during a recent visit. The country's last Article IV review was in January 2008; the 2009 review had been delayed by April elections, but a mission was likely in August.

HAITI

¶14. (SBU) Haiti, like CAR, was on the verge of completion point. The IMF reported that acceptable progress had been made on 11 of the

15 triggers, though four waivers had been requested. The U.S. asked

about the recent minimum wage increases; the Fund responded that staff were concerned about the risk of contagion to all public sector wages, which could cost 0.4% of GDP. The Club will negotiate completion point treatment with Haiti on July 8.

KAZAKHSTAN

¶15. (SBU) The IMF opined that despite current banking problems, the longer-term outlook was positive, with oil output expected to double by the middle of the next decade as the Kashagan field comes on line. External assets totaled about $20 billion, public debt was low, and growth prospects good.

¶16. (SBU) More immediately, though, the country had been hit by two shocks -- the unraveling of financial markets and the drop in oil prices from their 2008 peaks. Kazakh banks had borrowed heavily in international markets, especially in 2006 and early 2007. For a while they had been cushioned by high oil prices, whose fall had had major effects on the economy, with growth having fallen from 10% per year in mid 2007 to an estimated -2% currently. The current account had returned to deficit, though inflation had eased below 9% in May. The banking sector, however, faced serious solvency risks, with

non-performing loans having soared and amidst serious doubts about the values of external assets (BTA, for example, had 40% of its assets in Russia). The banks had about $40 billion in external liabilities, of which about a quarter matured in 2009. Three major institutions - BTA, Alliance, and Astana Finance - had stopped making principal payments in April.

¶17. (SBU) The government had responded with an anti-crisis program totaling 10% of GDP, designed to stabilize banks and stimulate the economy. The banking measures included injecting $2.2 billion in capital into the top three banks (with the government having taken a controlling share of BTA in February), deposits from the public development agency, and crisis spending being channeled through banks. Nevertheless, the situations at BTA and Alliance had continued to deteriorate, leading to the April standstill.

¶18. (SBU) Kazakhstan had made no request for Fund support. IMF Managing Director Strauss-Kahn had visited recently; on July 1, the Executive Board would discuss results of the 2009 Article IV mission. The Bank noted that despite the "big three" defaults, many banks continued to honor their commitments and in fact banks' external debts by April had fallen to $33 billion from the $40 billion cited by the Fund. Of this, $12 billion would fall due in 2009; $5-6 billion, in 2010. Reserves had actually risen $2 billion in April and May after falling $6.5 billion in the first quarter.

The country had also attracted loan commitments of $10 billion from China, $3.5 billion from Russia, and $1 billion from the UAE.

¶19. (SBU) The Secretariat noted that a number of Club ECAs had exposure to the nationalized BTA, and that major questions for the Club were whether the government had extended guarantees to cover these debts, and whether the Club should take coordinated action, as several ECAs had done in a joint letter. The ECAs had received a reply from the President (which we had not seen), stating that the government was not assuming the debt.

¶20. (SBU) Italy, which had requested discussion of Kazakhstan, sought coordinated action to support the ECAs. Italy indicated that Kazakhstan and its advisors were seeking a substantial haircut, which was at odds with the country's outlook. Italy noted that GOK infighting and corruption were impediments to a solution. Numerous creditors reported exposure to the banks, including Austria, Belgium, Canada, Denmark, Finland, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the UK, and the U.S. Creditors arguing for a Club role suggested that the nationalization of BTA made the GoK responsible for its debts, and cited the argument made

by the ECAs that their debts should be senior to others. (We had not seen the letter before it was sent and do not know the grounds for this argument, beyond that the defaults could threaten future ECA lending.)

¶21. (SBU) The Secretariat said negotiations on resolving Alliance were scheduled for July, and for BTA in August; if the Club were to act, it would need to do so soon. There was general support for a Club letter to authorities, but disagreement on what it should say. One faction (which included the U.S. and the Secretariat) urged a pared-down letter noting the Club's concern about the issues and their resolution; others urged that the letter assert GoK responsibility for the debts, repeat the ECAs' assertion of seniority, and indicate that a negative outcome for ECAs could affect any (highly theoretical) Club treatment for Kazakhstan. The Secretariat will prepare a draft, reflecting its toned-down preference. There will also be a data call ahead of further discussion in September. The Secretariat will also seek information from the EBRD.

MOLDOVA

¶22. (SBU) The Fund reported that a mission had taken place in late May/early June. Discussions of a proposed program had been suspended as a result of parliament's failure to elect a new president. The authorities would welcome an early visit after the late-July elections. The Bank reported little movement, except some

enterprise-related work, but noted one bank has serious liquidity problems. The bank could be closed or bailed out, and have a broader impact on the financial sector.

UKRAINE

¶23. (SBU) Ukraine was likely on the agenda because of concern about energy issues and the impact of continued political wrangling on policy reforms, although no Club issues were raised. The IMF reported that years of high growth (averaging over 7% per year since 2000) had created multiple vulnerabilities. By 2008 the economy was overheating badly, with 30% inflation, 70% credit growth, and soaring property prices. The current account deficit had reached 7% of GDP, with the hryvnia overvalued by 10-20%, and household and business balance sheets deteriorating because of borrowing in foreign currencies. Russia's phasing out of gas subsidies was followed by a reversal of capital flows. Ukraine was shut out of credit markets (though lines were mostly rolled over), spreads soared, and the country was downgraded. Banks came under strain, with runs on deposits.

¶24. (SBU) The Fund program that began in November was aimed at rebuilding confidence and restoring financial stability. Elements

included a flexible exchange rate policy, appropriate fiscal stance, and energy prices being moved towards international levels. The May 8 review had allowed a $2.8 billion disbursement from the Fund, and a mission was in the country. The current account had moved into balance as a result of recession, with GDP expected to fall more than 10% in 2009. There had been large outflows, but these had ended, as had deposit outflows. Exchange rate pressures had eased after a 35% depreciation, and inflation was falling.

¶25. (SBU) Financial sector reform was on track, with diagnostics completed. Most major banks - including all foreign-owned ones - had agreed to capital injections, although a few systemically

important local banks had not yet agreed and were still being "worked on." There remained large downside risks, including fiscal risk from Naftogaz. The Bank concurred about downside risk, pointing especially to refinancing risk for the private sector (which owed $22 billion in short-term debt and $16 billion in medium-term debt, with an estimated rollover rate of only 80%, much less than the financial sector's) and to the 2010 presidential elections.

Methodological Issues
SENIORITY OF NEW BILATERAL FINANCING

¶26. (SBU) There was discussion of the Secretariat's proposal to create a new seniority level - below the international financial institutions' (IFIs') preferred creditor status but above all other Paris Club debt - for bilateral loans made alongside the IMF in the context of the current crisis. The Secretariat outlined revisions in its third working paper on this topic. The IMF stressed need to preserve the IFIs' preferred creditor status. The U.S. indicated firmly that it would not agree to the proposal, for two principal reasons - additional seniority was not needed to provide incentives to make such bilateral loans, and it raised the specter of the Paris Club judging loans based on purpose and circumstances, rather than purely financial conditions.

¶27. (SBU) The Inter-American Development Bank (IDB) had offered a similar proposal to extend its preferred creditor status to bilateral creditors lending alongside it. Bank EVP Zelikow had discussed the Bank's proposal with the Secretariat. Without revealing the Club's discussions, the Secretariat had indicated to him that bilateral loans would have to be inferior to the Bank's. The U.S. indicated it would oppose the IDB proposal; the same arguments applied, and it made no sense to support special status for lending alongside the IDB while rejecting it alongside the Fund. There were no grounds for extending the IFIs' own preferred creditor status to loans in which they had no financial interest.

The Vice-Chairman noted that, given Multilateral Development Banks' (MDBs') desire to use seniority to elicit further bilateral lending, rejecting the proposal would increase pressure for MDB capital increases. Nonetheless, in view of various countries' reservations, the Secretariat undertook to tell the IDB that there was no Club consensus to support the IDB's proposal.

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Meeting with Non-Paris Club Official Creditors
and the Private Sector
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¶28. (SBU) The Institute of International Finance co-hosted the Club's annual meeting with the private sector. Non-Club official creditors that attended were Brazil, China, South Korea, Israel, Poland, Romania and Turkey; notably no Gulf countries accepted the Club's invitation this year. The IIF made presentations on its "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets," debt reconciliation, and litigating creditors. The Paris Club Secretariat presented recent Club activities and country cases.

¶29. (SBU) The IIF took an aggressive stance on litigating creditors, reporting its research, which identified 47 cases involving 11 HIPCs. Of those, 26 were settled out of court, and of the remaining

21, 3 involved financial investors. In most cases, the IIF argued, the cases were small relative to the countries' GDP. Among non-HIPCs, IIF was aware of fifty cases, of which nine were subject

to litigation. Excluding Argentina, the total sum involved was only $1.5 billion, and recoveries $230 million. Notably, IIF appeared unaware of the recent Congo-B settlement. IIF argued strongly that rights to litigation were essential for the functioning of markets, and that these had been weakened by recent GM and Chrysler developments. IIF argued litigation was expensive, rarely led to collections, and was usually not worthwhile. Individual IIF members pointed out that they sometimes had to file suit because of statutes of limitation; BNP Paribas noted that creditors that had not sued were kept out of Nicaragua's International Development Assistance (IDA)-supported debt buyback because their claims had been time-barred. The Secretariat responded that comparability of treatment was the key issue for the Club, and noted that some claims were big, and that some HIPCs could not afford even small amounts.

¶30. (SBU) The African Development Bank's (AfDB) General Counsel solicited support for the Bank's African Legal Support Facility, noting that it had received twenty requests for support. The facility had signed up forty African members, but only two donors - Belgium and Brazil - ahead of its formal launch on June 29. (Club Chairman Ramon Fernandez said that France will join.) The fund has

$50 million and an additional $10 million in pledges, and seeks to mobilize $50 million in the coming year.

¶31. (SBU) The discussion of Ecuador yielded the most interesting argument: an observation from Hans Humes of Greylock that the buyback demonstrated how little power private creditors had, despite the concerns about litigating creditors and vulture funds. Humes claimed private sector creditors had been undermined by IDB lending to Ecuador; the country did not have to reach agreement and forced private creditors to capitulate.

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CONFERENCE ON THE WORLD CRISIS AND ITS IMPLICATIONS
FOR EMERGING AND DEVELOPING COUNTRIES
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¶32. (SBU) The Conference attracted a number of high-level speakers, including French Minister Lagarde, John Lipsky of the IMF, Christian Noyer of the Banque de France, former European Bank for Reconstruction and Development (EBRD) President Jean Lemierre, AfDB President Kaberuka, finance ministers from Indonesia and Cameroon, and the central bank governors of Hungary and Ghana. Most of the speakers covered familiar ground, but there were some interesting points:

-- Lipsky was optimistic, saying fears of a serious setback had been overcome and that the Fund was likely to increase growth forecasts. The U.S. banking crisis was receding, due to capital raising, stress tests, and earnings, and called for countries to develop exit strategies from crisis policies. Lipsky questioned the value of accumulating large reserves, noting that reserves had become unusable during the crisis since spending them caused confidence to drop. Noyer observed that even countries with large reserves (such as Russia and China) had been hit, suggesting that markets were focused on flows rather than balance sheets.

-- Indonesian Finance Minister Sri Mulyani Indrawati noted her country had been relatively insulated from the crisis, and that the economy was still growing. Nevertheless, it had been affected by falling capital flows and negative perceptions. While volatility was declining, the worst could still be ahead. She described Indonesia as an "innocent victim" of the current crisis and had pointed remarks about the IMF (the photo of Camdessus "cannot be eliminated" from Indonesians' minds); Asian countries' belief, based on the response of "West-dominated institutions" to the Asian financial crisis, that they need their own "self-insurance" and regional efforts to address vulnerabilities; and the negative impact on all countries of a volatile dollar. With speakers from Australia

and Japan, she discussed regional support efforts for Indonesia. When asked whether there was a conflict between such efforts and

G-20 agreement to strengthen the Fund's role, she said she wished she could trust the Fund, but that her first priority had to be protecting Indonesia.

-- Hungarian Central Bank Governor Simor acknowledged his country's errors in building vulnerabilities, while arguing that all of them came to a head a week after the Lehman Brothers failure. He noted that Hungary had followed procyclical policies before the crisis hit and was forced to follow procyclical policies now.

-- AfDB President Kaberuka deftly sidestepped a question about the bank's views on China's role in Africa. Referring to the 2007 AfDB Annual Meetings held in Shanghai, he noted that China was an AfDB member and an "important partner for Africa," but went on to emphasize the importance of debt sustainability and of enhancing African countries' capacity to negotiate contracts that provide advantages to both parties and take into account debt sustainability.

-- In response to a question about Ghana's heavy borrowing on non-commercial terms, Central Bank Governor Acquah admitted that the Eurobond had been expensive, but argued that the coupon rate was not high at the time of issuance. He asserted that many of the proceeds were used for infrastructure before the food and fuel price increases and elections affected spending priorities.

-- Otaviano Canuto of the World Bank presented a detailed discussion of the Debt Sustainability Framework review, which the G-7/G-20 had tasked the Bank and Fund to complete by the 2009 Annual Meetings. Areas being examined included the linkage between investment and growth, threshold effects from use of the CPIA, inclusion of remittances in the analysis, updating the discount rate, and treatment of SOEs. A paper would be sent to the Executive Board the last week in August, in preparation for the Annual Meetings.
PEKALA